

THE SPECTRE OF PROTECTIONISM STILL HAUNTS AUSTRALIA'S ECONOMY

Political parties must resist the siren's call of protectionism's cheap popularity, argues **Simon Cowan**

Over the past half century, Australia has transitioned from a highly protectionist economy to one that is much more open to foreign investment and exports from around the globe. This transition has not been seamless, nor has it been uniformly welcomed, but it has coincided with long periods of high economic growth, increased productivity, and a genuine improvement in the living standards of many Australians.

Unfortunately, protectionism remains in vogue in some circles. President Obama's auto industry bailout is believed to have helped him win key states such as Ohio in the 2012 US presidential election.¹ Some commentators have called for Australia to adopt Obama's protectionist approach to support local manufacturing.² There are ongoing calls for assistance to deal with the high Australian dollar.

One stark and self-evident problem with protectionism is that once an industry is given protection, it creates vested interests in maintaining (and increasing) the level of protection. Not surprisingly, the voices of these vested interests are the most vociferous in calling for even greater protection. For example, Dave Smith, national secretary of the vehicles division of the Australian Manufacturing Workers Union, has called for all levels of government to prefer using Australian-made cars rather than procuring cars that can best meet government needs or those that represent the best value for money.³

Troublingly, the Australian government is increasingly supporting protectionist measures such as its anti-dumping taskforce, ongoing assistance to manufacturing, and moves to prefer local suppliers in government procurement.

Yet again, Australians find themselves asking whether protectionism is a major problem. What is so bad about helping one's own if it shores up jobs? Isn't the Australian economy doing well enough that we don't need to worry about the last vestiges of the old protectionist regime?

Australia's protectionist history and Bert Kelly

If the arguments for and against protectionism seem familiar, it's because protectionism has been the topic of one of Australia's oldest debates, one that perhaps the forces of commonsense thought had been won. Unfortunately, the trend in Australia appears to be a return to the bad old days of protectionism.

In December 2012, The Centre for Independent Studies held the Sydney launch of Hal Colebatch's biography of Bert Kelly titled *The Modest Member*. In it Colebatch documents the almost single-handed struggle that Kelly waged against the heights of Australia's protectionist regime half a century ago.

Kelly has always been an interesting person and the book is an interesting read (notwithstanding its biographer's tendency to indulge in effusive deification of his subject).



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While it should not be forgotten that Kelly represented a primarily agrarian electorate that was particularly hurt by protectionism, then as is the case now, an anti-protectionist position did Kelly no favours politically.

Kelly himself identified the key motivator of the protectionism regime:

I have a suspicion that the Government's real policy is a determination to be loved by all; like Caesar's wife, to be all things to all men ... It is probably this hunger for love and affection that has led to the change in the grounds for granting emergency protection.⁴

In an environment where political parties focus on providing immediate reactions to opinion polls and governments are constantly trying to win over special interest groups with promises of increasing welfare protections, it is hardly surprising that protectionism (essentially welfare for corporations) would come back into fashion.

Popular support for corporate welfare

As was the case in Kelly's time, it seems the voting public remains largely unaware of either the extent or effectiveness of protectionism. For example, the public generally seems to support the ongoing calls to protect the manufacturing sector, but few are likely to be aware that the sector already receives more than \$7.5 billion a year in industry assistance through tariffs and direct budgetary aid.⁵

In the Winter 2004 issue of *Policy*, Andrew Norton noted the long history of stubborn support for protectionist policies—for example, even in 1998 (40 years after Kelly entered Parliament as the member for Wakefield), a mere 11.3% of people disagreed with the notion that Australia should continue to use tariffs to protect industry. However, Norton also noted that opinion polls on the Australia-United States Free Trade Agreement showed that public opinion might be changing.

Despite the obvious successes of reforms to tariffs, Norton's predictions were optimistic.

Only 18% of respondents in an Essential Media poll in January 2012 opposed further aid to the automotive manufacturing industry, while 62% supported extending this aid to other manufacturing sectors.⁶

In Ohio, a key battleground state in the recent US presidential election, 59% of voters supported a multibillion bailout of the car manufacturing industry. Three-quarters of these voters voted for Obama. This is in the United States, a country with a proud heritage of advocating free trade.

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Though some optimism is perhaps warranted in Australia after all. In an unofficial poll on *The Age* website on 19 July 2012, 76% of the more than 4,300 respondents disagreed that government support of the car manufacturing industry is money well spent.⁷ Maybe the public is slowly becoming aware of how ineffective protectionism is in maintaining the health of the protected industries—despite the auto industry continuing to receive in excess of \$1 billion a year in assistance, more than 1,000 jobs were lost in the sector in 2012.

Interestingly, the economics profession, which is notorious for its complete inability to agree on anything, is largely united on the economic inefficiencies of protectionism. In 2011, only 26.6% of Australian economists disagreed with the statement that 'Australia should unilaterally reduce all artificial barriers to international trade including subsidies, tariffs and import quotas.'⁸

A snapshot of industry assistance today

The Productivity Commission produces an annual report, *Trade & Assistance Review*, on the levels of industry assistance in Australia that details the most heavily (overtly) protected sectors.

Table 1: Industries receiving high levels of assistance (in \$ millions)⁹

Industry	Tariffs	Direct	Total assistance
Manufacturing			
- Metal product manufacturing	1,437.8	115.6	1,553.5
- Food, beverage & tobacco	1,179.9	118.9	1,298.8
- Motor Vehicles & parts	660.7	519.2	1,179.9
- Petroleum, coal & chemicals	736.2	234.5	970.7
Primary production			
- Grain, sheep & beef cattle	-25.4	644.4	618.9
Services			
- Finance & insurance	-27.4	614.4	586.9

Source: Productivity Commission, *Trade & Assistance Review 2010–11*.

Between 2005–06 and 2010–11, the annual assistance to industry increased by \$2 billion in nominal terms (approximately 22%).¹⁰ While the nature of assistance has changed, from largely tariff-based support up to the 1990s to a preference for direct financial assistance (tax breaks and co-investment) in the 2000s, many industries that have never been able to compete internationally are still being supported by the government.

However, tariffs and budgetary assistance do not represent the complete extent of protectionism in Australia today. Governments, perhaps aware of the increasing perception of industry assistance as rent-seeking and mindful of international commitments to reduce protection, continue to support industries with more covert protectionist measures.

These covert measures are difficult to quantify but could be significant. Protectionist measures such as governments preferring local manufacturers in procurement decisions could amount to billions of dollars in assistance given the size of government procurement budgets.

Sometimes this local industry preference is further hidden behind a veneer of ‘national interest,’ as in defence, where billions of dollars are spent on procurement every year. So-called national interest is also behind attempts to limit foreign investment in agriculture and impose import bans to protect Australian primary producers.

Other government actions that can be protectionist (yet obscured from scrutiny) include operating inefficient state-owned enterprises, local content quotas for television, and government-backed guarantees (such as those offered to major banks in times of crisis or to exporters via the Export Finance and Insurance Corporation). Even foreign aid has the potential to be used for protectionist purposes.

Other illusory attempts to justify protection include earmarking support as transitional assistance. As the multi-decade ‘transitional’ support for the automotive industry shows, this transitional support can become permanent.

Some protectionist myths

The arguments supporting protectionist intervention generally are not based in sound economic reasoning but typically resort to myths or populist rhetoric. These superficially appealing arguments have been comprehensively rebutted, but continue to dominate popular discourse on protectionism.

Myth 1: Protectionism helps keep local jobs

Why it is wrong: Protectionism harms employment in the broader economy and job prospects for those in the protected industry by reducing competitiveness and productivity

The myth that protectionism supports local jobs is pervasive because of its superficial logic, but there are numerous holes in this argument.

First, protected industries do not exist in a vacuum. It may be politically convenient to protect Australian steelworkers, but this increases costs for all users of Australian steel (including Australian manufacturers who employ other Australian workers). This in turn makes other industries less competitive and reduces employment in those sectors. Free trade on the other hand increases productivity through increased competition and technology transfer.

Second, protectionism must be paid for somehow—budgetary assistance requires higher taxes, while tariffs reduce investment in efficient industries, raise costs of production, and reduce the purchasing power of consumers (affecting total demand). These factors impede overall employment at the macro level.

Third, the argument that protectionism keeps local jobs is compelling strictly in the short term and only in its effects on the protected industry. Research on the bigger picture has found ‘fairly strong evidence’ that ‘unemployment and trade openness are negatively related’ (i.e. countries with higher levels of protection also have higher levels of unemployment).¹¹

Protectionism might create positive media stories for politicians (who can ‘save’ jobs) but it is free trade that creates employment.

Myth 2: Protectionism is needed because the playing field isn't level

Why it is wrong: The tilted playing field benefits Australian consumers and the Australian economy.

This myth is appealing to the ‘fair go’ spirit but also has numerous flaws when examined closely.

First, the benefits of trade arise because the playing field between countries and industries isn't level. ‘Comparative advantage’ relies on different relative costs of production existing in different countries. The playing field will never be completely level.

Second, regardless of any subjective ‘fairness’ for a particular industry, protection still has a harmful impact on the economy as a whole and all other local industries competing with that industry for resources (protection has to be paid for somehow). Those other industries hurt

by protectionism are unlikely to see it as ‘fair.’ Consider the examples that Kelly cites in his speeches—most of them involve the increased costs borne by primary producers because of tariff protection given to manufacturing.

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Third, even if the focus were on the subjective unfairness of foreign protectionism in a particular industry, the benefits to consumers and the economy still outweigh the losses to the affected industry. Foreign governments subsidising exports to Australia is a transfer of wealth from the taxpayers of the foreign country to Australian consumers and businesses.

The very fact that a playing field is tilted against domestic producers often means that it is also tilted in favor of domestic consumers. Foreign subsidies of imported products, in particular, increase the economic welfare of the domestic country.¹²

Moreover, protection rarely just levels the playing field; rather, it typically tilts in favour of domestic producers (who have an interest in securing as much protection as possible). This protection is a transfer of wealth away from Australian taxpayers to foreign consumers.

There is also the risk that subsidy ‘wars’ might break out between countries where each country in turn increases its protection to benefit industries. It seems unlikely that the process of countries battling to introduce matching subsidies would result in an overall lowering of protection.

Myth 3: Protectionism protects the Australian way of life

Why it is wrong: Many of the benefits of protection flow overseas while harming Australian consumers and taxpayers

Perhaps one of the most paradoxical and illogical argument of all is that protectionism

protects Australian interests and the Aussie way of life. It's illogical because, while protectionism provides some benefits to Australian manufacturers (at the expense of Australian taxpayers and consumers), much of the benefit flows through to foreign consumers and foreign businesses (e.g. through lower prices for exports or profits, or revenue for overseas parent companies of protected subsidiaries).

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The benefits of free trade can be easily shown without needing to cite qualitative, ethereal benefits such as increased cultural awareness or multiculturalism. Free trade increases the purchasing power of Australian consumers and increases productivity (which is a factor in increasing wages growth). Therefore, free trade increases living standards. Surely Australia's interest is to secure the greatest economic benefit for all its residents? Even those driving foreign utes with anti-immigration slogans on them should be able to see that increasing prosperity will do a better job of safeguarding the Australian way of life than protectionism?

Conclusions

Australia is having the free-trade debate (again) because the vested interests that benefit directly from protectionism have a loud voice in the media and some sway over the government.

Protection is popular, especially among those who do not know that it has no economic rationale. It is a superficially convincing concept: cameras can be directly pointed at jobs 'saved'

by protection, but it is harder to identify benefits created by free trade.

Yet the benefits that lowering protection generates for the economy as a whole are unambiguous. Political parties must resist protectionism's cheap popularity. Bert Kelly is no longer around to remind governments of the folly of tariffs. Hopefully a new generation is not needed to take his place as a lonely voice of economic reason.

Endnotes

- 1 See Steve Mufson, 'Auto industry bailout key to Obama's win in Ohio,' *The Independent* (7 November 2012); Joe Hallett, 'Auto bailout, high turnout helped Obama win Ohio,' *The Columbus Dispatch* (8 November 2012).
- 2 See Tim Colebatch, 'Call for manufactured success,' *The Sydney Morning Herald* (28 March 2012).
- 3 AMWU (Australian Manufacturing Workers Union), 'AMWU pressures councils, states on car shame' (22 November 2012).
- 4 Quoted from Economics.org.au.
- 5 Productivity Commission, *Trade & Assistance Review 2010-11*, Annual Report Series (May 2012).
- 6 See Essential Media, 'Support for additional assistance to car industry' (23 January 2012) and 'Support for other manufacturing sectors' (23 January 2012).
- 7 Clay Lucas and Richard Willingham, 'Ford cuts leave PM red faced,' *The Age* (18 July 2012).
- 8 The Economics Society of Australia, *Policy Opinion Survey of Australian Economists 2011* (2011).
- 9 Productivity Commission, *Trade & Assistance Review 2010-11*, as above.
- 10 As above.
- 11 Pushan Dutt, Devashish Mitra, and Priya Ranjan, *International Trade and Unemployment: Theory and Cross National Evidence* (January 2009).
- 12 Alan V. Deardorff, *Economic Effects of 'Leveling the Playing Field' in International Trade* (International Policy Centre University of Michigan, July 2009).